Legal Decisions[1]

Income-tax Act

LD/62/75

Mrs. Smita Anand, China, In re

19th February, 2014 (AAR)

Section 6 of the Income-tax Act, 1961 – Residential Status

When the applicant resigned from her employment in China, the reason for return to India does not seem to be only for a visit in absence of proof that the applicant left India thereafter for any employment; in such a case Explanation (a) to section 6(1)(c) will not be applicable and that being so the total stay in India of the applicant for the preceding four years is for a period amounting to more than 365 days and total stay in India for the current year is for a period amounting in all to 119 days which is more than 60 days, requirements of sub-section (c) of section 6(1) is met by the applicant to become a resident in India

The applicant is an Indian citizen and a person of Indian origin. She was working with Hewitt Associates (India) Private Limited from April, 2002 till September, 2007. On 22nd September, 2007, the applicant left India for the purpose of employment with Hewitt Consulting (Shanghai) Company Limited, which is a company incorporated in China. The applicant's employment with Hewitt (Shanghai) commenced on 1st October, 2007. During her employment in China, she visited India and her stay in India in a particular year never exceeded 182 days. She returned to India on 12th February, 2011 after resigning from her employment in China with effect from 31st January, 2011. During the financial year 2010-11 which is the relevant year in this application, her total stay in India was 119 days. The applicant continues to enjoy status of non-resident as per domestic tax laws of India during the financial year 2010-11.

Submission of the applicant is that in terms of *Explanation* (a) and/or (b) to Section 6(1), the period of stay in India should be 182 days

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.in. For full judgment, write to eboard@icai.in*

or more and the applicant's total stay in India during the period is 119 days and therefore, her residential status is non-resident during the relevant previous year. The Revenue's contention is that *Explanation* (a) or (b) to Section 6(1) is not applicable in the applicant's case and her total stay in India during the previous year being more than 60 days, the applicant's status is resident in India and the amount received during the previous year from any source is taxable in India.

The Authority for Advance Rulings held as follows: *Explanation* (a) to Section 6(1)(c) is applicable only in a particular year when a person leaves India. In the context of the application and the arguments made by the applicant, *Explanation* (a) read that the assessee being a citizen of India, who leaves India in any previous year for the purpose of employment outside India, the provision of sub-clause (c) shall apply in relation to that year as if for the words "60 days", occurring therein, the words "182 days" had been substituted. "In relation to that year" relates to the previous year in which a person leaves India. In effect, if a person leaves India in any particular year for the purpose of employment outside India and if his/her stay in India in that particular year is for a period or periods amounting in all to 182 days, his/her status will be resident in India.

This is not the case in the present applicant's case. The relevant FY in which the applicant left India for the purpose of employment was therefore 2007-08 which is not the subject matter in this case. Besides the applicant left India in September, 2007 and come back to India on 12th February, 2011 after resigning from her employment in China effective on 31st January, 2011. In the decision of the ITAT Bangalore Bench in the case

of *Manoj Kumar ReddyNare vs. ITO [2009] 132 TTJ 328* it was held that the assessee has come to India after leaving his employment outside India, the *Explanation* (a) to Section 6(1)(c) will not be applicable. That being so, the total stay in India of the applicant for the preceding four years is for a period amounting to more than 365 days and total stay in India for the FY 2010-11 is for a period amounting in all to 119 days which is more than 60 days, requirements of sub-Section (c) of Section 6(1) is met by the applicant to become a resident in India.

Regarding the arguments relating to *Explanation* (b) to Section 6(1)(c), the test is whether the applicant had come on a visit to India in the previous year 2010-11 as a non-resident. There is no denying of the fact that the applicant had come to India from China after resigning from her employment. It cannot be said that the applicant is a non-resident in that particular year as this is the point in dispute now. If she is not a non resident, one limb of the *Explanation* falls. The other issue is whether she came to India only for a visit. The applicant argued that was so and the Revenue submitted that she did not come to India only for a visit as her return to India is after resigning from her employment in China. The facts and circumstances of the case make one to believe that the applicant did not come to India only for a visit. The assessee's argument that the applicant's employer card was valid upto 31.03.2012, the applicant was considerably exploring possibility of job outside India, the residential house property owned by the applicant jointly with her husband had been let out till June, 2011, the applicant visited her friends and relatives in different parts of India and also travelled different locations on holidays, the children of the applicant were staying abroad at the time when applicant came to India etc., are not sufficient to conclude that the applicant came to India on a visit only. The applicant could very well resign even during the validity period of the employer's card and that is what she has done. The activities mentioned by the assessee need not be necessarily proof of a visit, even a person staying permanently in India also does those activities. If a person returns to India after a long period of

absence there is all the more reason he or she will like to go to visit relatives and friends in different places. Those activities are not necessarily indicators of a visit. When the applicant resigns from her employment in China, the reason for return to India does not seem to be only for a visit. The assessee could not give information whether the applicant left India thereafter for any employment. In such circumstances it cannot be said that the applicant came to India only for a visit. On facts and circumstances of the case it is to be held that *Explanation* (b) to Section 6(1)(c) of the Act is also not applicable in the applicant's case.

Thus, the applicant's case does not fall under *Explanation* (a) or (b) to Section 6(1)(c) and having fulfilled the requirements of Section 6(1)(c) of the Act her status will be resident in India. Consequently, the amount of proceeds received in India on conversion of ESOPs and RSUs awarded to her by her employer in China will be taxable in India.

LD/62/76

Booz & Company (Australia) Pvt. Ltd., Australia, In re

14th February, 2014 (AAR)

Section 9 read with Section 44DA and 115A of the Income-tax Act, 1961 – Income - Deemed to accrue or arise in India

The essential features of "business connection" is that (a) a real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities within India; (b) such relation shall contribute, directly or indirectly, to the earning of income by the non-resident in his business; (c) a course of dealing or continuity of relationship and not a mere isolated or stray nexus between the business of the non-resident outside India

and the activity in India, would furnish a strong indication of 'business connection' in India.

Ten applications involve identical disputes concerning Double Tax Avoidance Agreement of different countries. Ten applicants are members of same group but incorporated in different countries. All of these companies provided Indian Group Company different services.

The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.

The basic issues raised before AAR are (1) whether the amount payable is to be treated as Fees for Technical Services (FTS) or business income? (2) whether the amount payable would be chargeable to tax as FTS u/s 115A read with Section 9(1)(vii) as well as Section 44DA or as business income? (3) and whether payment by Booz India to the respective applicant is subject to withholding tax @ 10% as per Article 12?

The Authority for Advance Rulings held as follows:

Aspect of "Permanent Establishment"

Under the Double Tax Conventions, right of the contracting States to tax the business profits of an enterprise of other contracting State arises only if the enterprise carries on its business in the first mentioned State through a "Permanent Establishment" ('PE') situated therein. PE is generally classified into five categories:

i. Fixed place PE;
ii. Construction PE;
iii. Installation PE;
iv. Service PE:
v. Dependent Agency PE

One of the *sine qua non* of a fixed place PE is that the fixed place of business through which the business is carried on should be 'at the disposal'.

It is of significance, that Organisation for Economic Co-operation and Development (in short "OECD') does not expressly define what constitutes the place to be 'at the disposal' of the taxpayer and instead gives examples wherein it may or may not tantamount to 'right of disposal'. Conducting trading operations generally require a fixed place which the taxpayer uses on a continuous basis. However, taxpayers rendering service usually do not require a place to be at their constant disposal and therefore application of 'disposal test' is generally more complex in such cases. In some jurisdictions the 'disposal test' is satisfied by the mere fact of using a place. In some other jurisdictions it is stressed that something more is required than a mere fact of use of place.

A taxpayer who is obliged to perform independent personal services without having a PE of his own, is deemed to have a PE where he performs his services.

Various factors have to be taken into account to decide a 'Fixed place PE' which *inter alia includes a right of disposal over the premises.* No strait jacket formula applicable to all cases can be laid down. Generally, the establishment must belong to the Employer and involve an element of ownership, management and authority over the establishment. In other words the taxpayer must have the element of ownership, management and *authority over the establishment.*

On the issue of Agency PE the relevant question is "business connection"

A perusal of provisions of Section 9(1)(i), shows that all income accruing or arising whether directly or indirectly through or from any business connection in India or from any property in India or through any assets or source of income in India or through transfer of capital assets situated in India, shall be deemed to accrue or arise in India. The mandate contained in Clause (a) of the *Explanation* is that for the purpose of the aforementioned clause, where the business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. The other clauses of the *Explanation* are not relevant. The expression "business connection" was not defined

for the purpose of the aforementioned provisions, before 31st March, 2003. By the Finance Act, 2003, two Explanations were inserted after the then existing *Explanation* which are numbered as *Explanation* 1 and 2 to sub-Section (1) of Section 9 w.e.f. 1st April, 2004.

It may be seen that *Explanation* 2 contains an inclusive definition; it brings in the business activities specified in Clauses (a) to (c), within the fold of the expression "business connection" which has to be understood in its ordinary meaning.

The essential features of "business connection" may be summed up as follows:

(a) a real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities within India;

(b) such relation shall contribute, directly or indirectly, to the earning of income by the non-resident in his business;

(c) a course of dealing or continuity of relationship and not a mere isolated or stray nexus between the business of the non-resident outside India and the activity in India, would furnish a strong indication of 'business connection' in India.

Apart from the fact that requirements of *Explanation* 2, are satisfied, the facts of the instant case would also fulfill the aforementioned essential features of business connection.

Having held that the applicants have Permanent Establishment in India, the incomes received by them from the Indian Company are taxable as business profit under Article 7 of the Tax Agreement of India and the respective countries.

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LD/62/77

Director of Income Tax (International Taxation)

vs.

M/s Nisso Lwai Corporation, Japan

4th February, 2014 (AP)

[Assessment Year 1991-92]

Section 9 of Income-tax Act, 1961 – Income – Deemed to accrue or arise in India

Where Tribunal found that the amounts was received by the assessee Japanese company for supply of design and engineering drawings, since there has been no accrual of income in India and this accrual of income has taken place in Japan, as such, the Income Tax Act cannot be made applicable to the assessee company

In *M/s. Nissho Iwai Corporation vs. ACIT [ITA No. 372/Vizag/2002 dated June 22, 2010]*, the Visakhapatnam Income Tax Appellate Tribunal held that the amount received by the assessee for supply of design and engineering drawings is in the nature of plant and since the preparation and delivery has taken place outside Indian territories, the same cannot be subjected to tax in India.

In that case the assessee is a non-resident company. The assessee company has provided design and engineering services, manufacture, delivery, technical assistance through supervision of erection and commissioning *etc.*, to establish compressor house for a steel manufafturer. The payments were made by the steel manufafturer separately for each of the services/equipments provided/supplied by the assessee. It, *inter alia,* included payment made towards supply of design and engineering drawings. The assessee company claimed the said payment is not taxable under the Indian Income Tax Act as it was a transaction of sale of goods that has taken place outside India. The said claim was rejected by the AO and his order was confirmed by CIT (A).

The Visakhapatnam Income Tax Appellate Tribunal held that as per the original contract that the supply of design and drawing documents had to take place outside India. The relevant clauses dealing with the Supply of drawing and documentation stated that the Prime Contractor would transfer, deliver and impart the designs and drawing to the representative designated for that purpose by Purchaser in Japan or at the request of the Purchaser by transmitting the same either by surface mail or air mail or through a carrier in which case the post office or such carrier in Japan would be the agent of the Purchaser. Property in the designs and drawings shall vest with the Purchaser on the same being transferred, delivered and imparted to the representative of the Purchaser in Japan or when the packet containing the design and drawings is delivered

either to the post office or to a carrier designated by the Purchaser in Japan as the case may be.

According to the clauses cited above, the preparation and delivery of design and drawings have to take place in Japan. Since the contract was entered into between the parties prior to the commencement of construction of the impugned project, in the absence of any other contrary evidence, it has to be accepted that the preparation and delivery of the said documents have taken place in Japan.

In the instant case also, all the parts of the transactions have taken place outside the Indian soil and hence the impugned transaction falls outside the purview of Indian taxation.

The amount received by the assessee for supply of design and engineering drawings was in the nature of plant and since the preparation and delivery has taken place outside Indian territories, the same could not be subjected to tax in India.

The Andhra Pradesh High Court held as follows:

Where Tribunal found that the amounts was received by the assessee Japanese company for supply of design and engineering drawings, since there has been no accrual of income in India and this accrual of income has taken place in Japan, as such, the Income Tax Act cannot be made applicable to the assessee company.

LD/62/78

CIT- Tax-VII, New Delhi

vs.

Punjab Stainless Steel Industries

5th May, 2014 (SC)

Section 80HHC of the Income-tax Act, 1961 – Deductions – Profits from Export Business

Where respondent-assessee was not primarily dealing in scrap but was a manufacturer of stainless steel utensils, only sale proceeds

Legal Update

from sale of utensils would be treated as his "turnover"

When a recognised body of Accountants (The Institute of Chartered Accountants of India), after due deliberation and consideration publishes certain material for its members (Guidance Note on Tax Audit Under Section 44AB of the Income Tax Act), one can rely upon the same

The assessee is a manufacturer and exporter of stainless steel utensils. In the process of manufacturing stainless steel utensils, some portion of the steel, which cannot be used or reused for manufacturing utensils, remains unused, which is treated as scrap and the respondent-assessee disposes of the said scrap in the local market and the income arising from the said sale is also reflected in the profit and loss account. For the purpose of availing deduction under Section 80HHC for the relevant Assessment Year, the assessee was not including the sale proceeds of scrap in the total turnover but was showing the same separately in the Profit and Loss Account.

According to the Revenue, the sale proceeds from the scrap should have been included in the 'total turnover' as the respondent-assessee was also selling scrap and that was also part of the sale proceeds.

The Supreme Court of India held as follows:

Ordinarily a businessman by word "turnover" means the sale proceeds of the goods (the things in which he is dealing) that is sold by him.

So far as the scrap is concerned, the sale proceeds from the scrap may either be shown separately in the Profit and Loss Account or may be deducted from the amount spent by the manufacturing unit on the raw material, which is steel in the case of the respondent-assessee, as the respondent/assessee is using stainless steel as raw material, from which utensils are manufactured. The raw material, which is not capable of being used for manufacturing utensils will have to be either sold as scrap or might have to be re-cycled in the form of sheets of stainless steel, if the manufacturing unit is also having its re-rolling plant. If it is not having such a plant, the manufacturer would dispose of the scrap of steel to someone who would re-cycle the said scrap into steel so that the said steel can be re-used.

When such scrap is sold, the sale proceeds of the scrap cannot be included in the term 'turnover' for the reason that the respondent-unit is engaged primarily in the manufacturing and selling of steel utensils and not scrap of steel. Therefore, the proceeds of such scrap would not be included in 'sales' in the Profit and Loss Account of the respondent-assessee.

The situation would be different in the case of the buyer, who purchases scrap from the respondent-assessee and sells it to someone else. The sale proceeds for such a buyer would be treated as "turnover" for a simple reason that the buyer of the scrap is a person who is primarily dealing in scrap. In the case on hand, as the respondent-assessee is not primarily dealing in scrap but is a manufacturer of stainless steel utensils, only sale proceeds from sale of utensils would be treated as his "turnover".

The Institute of Chartered Accountants of India (hereinafter referred to as the 'ICAI') has published some material under the head "Guidance Note on Tax Audit Under Section 44AB of the Income Tax Act". The said material has been published so as to guide the members of the ICAI. When a recognised body of Accountants, after due deliberation and consideration publishes certain material for its members, one can rely upon the same.

The meaning given by the ICAI clearly denotes that in normal accounting parlance the word "turnover" would mean "total sales" as explained hereinabove. The said sales would definitely not include the scrap material which is either to be deducted from the cost of raw material or is to be shown separately under a different head. There is no reason for not accepting the meaning of the term "turnover" given by a body of Accountants, which is having a statutory recognition.

If all accountants, auditors, businessmen, manufacturers etc. are normally interpreting the term 'turnover' as sale proceeds of the commodity in which the business unit is dealing, there is no reason to take a different view than the view normally taken by the persons who are concerned with the said term.

In addition to the above factors, which has been considered for understanding the meaning of the term "turnover", none should miss the purpose with which the said term has been incorporated in Section 80 HHC.

The intention behind enactment of Section 80HHC was to encourage export so as to earn more foreign exchange. For the said purpose the Government wanted to encourage businessmen, traders and manufacturers to increase the export so as to bring more foreign exchange in our country. If the purpose is to bring more foreign exchange and to encourage export, it is to be held that the legislature would surely like to give more benefit to persons who are making an effort to help our nation in the process of bringing more foreign exchange. If a trader or a manufacturer is trying his best to increase his exports, even at the cost of his business in a local market, it is sure that the Government would like to encourage such a person. In our opinion, once the Government decides to give some benefit to someone who is helping the nation in bringing foreign exchange, the Revenue should

also make all possible efforts to encourage such traders or manufacturers by giving such business units more benefits as contemplated under the provisions of law.

Therefore, the proceeds generated from the sale of scrap would not be included in the 'total turnover'.

Note: Judgment of Delhi High Court in ITA No. 520 of 2006 dated 19-01-2007, Upheld.

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LD/62/79

AT & T Communication Services India (P) Ltd.

vs.

CIT-I

21st February, 2014 (DEL)

Section 142 of the Income-tax Act, 1961- Assessment – Inquiry, Prior to

Where the accounts including the documents, records and other material before the AO did make the issues for his decision complex requiring a special audit, contention of the assessee that the books of account were not called for and examined by the AO could not be accepted

Sub-Section (2A) of Section 142 does not require the "books of account" to be examined by the Assessing Officer It empowers the Assessing Officer, with the previous approval of the Chief Commissioner or Commissioner of Income Tax, to direct the assessee to get the accounts audited if he is of the opinion that it is necessary to do so *"having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue....."*. It has been held by a Division Bench of this Court in *Rajesh Kumar, Prop. Surya Trading vs. Dy.CIT (2005) 275 ITR 641*, that the expression "accounts" used in the section does not refer merely to "books of account" of the assessee; it could include the books of account, balance sheets and all other records which are available to the Assessing Officer during the assessment proceedings. It refers to the other records available with the Assessing Officer not only in the course of the assessment proceedings but also at any stage subsequent thereto. It was held that the expression "accounts" cannot be confined to books of account as submitted by the assessee, as it would amount to giving an interpretation which completely defeats the very object of the section. It was further held that the fact that the accounts of the assessee are subject to audit under some other statute is also no ground to hold that in such a case the Assessing Officer cannot direct a special audit. It was observed that in addition to the books of account, the Assessing Officer may also take into consideration such other documents related thereto and which would be part of the assessment proceedings. This judgment was followed by another Division Bench of this court in *Central Warehousing Corporation vs. Secretary, Department of Revenue & Ors (2005) 277 ITR 452 (DEL)*. In the light of these authorities, it is not possible to accept the contention that the Assessing Officer cannot direct a special audit unless he examines the books of account.

In the instant case, the Assessing Officer has taken the view that there is complexity in the accounts of the assessee. He has referred to the three segments or sources of revenue of the petitioner and has held that it is required to identify the method and the relevant accounting standard applicable for recognition of income from these revenues and also to ascertain the correctness of the income recognised. The profit and loss account, balance sheet and the computation of the income were before the Assessing Officer. It can hardly be disputed that the profit and loss account and the balance sheet fit the description of "accounts". The complexity arising out of such accounts is the difficulty in allocating the expenses incurred by the petitioner against the three segments of revenues namely; (i) market research, administrative support and liaison services; (ii) network connectivity services and (iii) managed network services. The Assessing Officer further proceeds to state in the impugned order that the allocation of costs/expenses impacts the profit and loss account (and the ultimate profit figure) and the method and the basis for such allocation is required to be verified and examined by the special auditor. The other

complexity adverted to by the respondent is the plea taken by the petitioner that the overseas payments cannot be characterised as fees for technical services but represented purchase price of goods and services and therefore there was no obligation on its part to deduct tax under Section 195. Yet one more complexity is the nature of the other costs debited in the profit and loss account which include infrastructure costs, last mile charges and inter group charges. The precise nature of these costs is required to be ascertained not only from the legal aspect but also from the accounting aspect, to determine the applicability of Section 40(a)(ia). One more important issue which according the Assessing Officer is quite complex is the "last mile charges". Noting that this is a heavily capital intensive project and the capitalised infrastructure is eligible for depreciation, the respondent has observed that the assessee has deducted the entire last mile charges from the services revenue thereby nullifying any income on this score. According to him the inclusion of the last mile charges in the profit and loss account as a debit, when the capitalised infrastructure cost is eligible also to depreciation, may amount to double deduction. Whether this would amount to double deduction is an aspect which the special audit was required to examined.

The question whether the accounts and the related documents and records available with the Assessing Officer present complexity is essentially to be decided by the Assessing Officer and in this area the power of the court to intrude should necessarily be used sparingly. It is the Assessing Officer who has to complete the assessment. It is he who has to understand and appreciate the accounts. If he finds that the accounts are complex, the court normally will not interfere under Article 226. The power of the court to control the discretion of the Assessing Officer in this field is limited only to examine whether his discretion to refer the accounts for special audit was exercised objectively, as far as the accounts, records, documents and other material present before the Assessing Officer would permit. There must be valid material before the Assessing Officer from which he apprehends that there is complexity. As to what material would make the accounts complex is essentially for the Assessing Officer to determine and unless his decision can be attacked on the ground of perversity or absolute arbitrariness or *mala fide*, it should not be interfered with. In the present case, the accounts including the documents, records and other material before the Assessing Officer did make the issues for his decision complex requiring a special audit. Accordingly, the contention of the assessee could not be accepted.

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Legal Update

LD/62/80

LS Cable & System Ltd., Korea Hyderabad Project, In re

14th February, 2014 (AAR)

Section 245R, read with section 143 of the Income-tax Act, 1961 – Advance Ruling – Procedure on receipt of application

Where return of income was filed before filing of the application before the Authority of Advance Rulings and notice u/s 143(2) was issued after the application was filed, the question cannot be said to be already pending before the Income-tax Authority, the application is admitted u/s 245R(2)

When returns are filed under Section 139 or in response to a notice under sub-Section (1) Section 142, they are processed under Section 143(1). While processing the return under Section 143(1) the total income or loss are computed after making the following adjustments i.e. (i) any arithmetical error in return; or (ii) an incorrect claim, if such incorrect claim is apparent from any information in the return. It is also provided that no intimation under that Section shall be sent after the expiry of one year from the end of the financial year in which the return is made. In *Explanation* to Section 143(1) of the Act, the expression "incorrect claim apparent from any information in the return" is also defined. The Revenue does not have any jurisdiction to examine or adjudicate any issue other than those mentioned in Section 143(1) of the Act. There is no scope for examining or adjudicating any debatable issue that requires long drawn arguments. Again only in those cases where the Assessing Officer has reason to believe that any claim of losses, exemption, deduction, allowances or relief made in the return is inadmissible or if he considers it necessary or expedient to ensure that the assessee has not under-stated the income or has not computed excessive loss or has not under-paid the tax in any manner, he can serve notice under Section 143(2). Before or without issuing notice under Section 143(2) or notice under Section 142(1) in cases whether return is not filed, there is no jurisdiction to examine or adjudicate debatable issue claimed or shown in the return of income.

Only when the issues are shown in the return and notice under Section 143(2) is issued, the question raised in the application will be considered as pending for adjudication before the Income-tax Authorities. The Revenue's contention that notice u/s 143(2) was issued within the stipulated time will not affect the stated position because without issuance of the notice, the Assessing Officer does not have jurisdiction to examine and adjudicate the issues raised in the question. Pending proceeding in general and question already pending for adjudication are not the same. For example, when a return of income is filed, it can be said that proceeding is pending till it is processed or deemed to have been processed u/s 143(1) of the Income-tax Act. However, that does not mean the issues raised in the questions filed before this Authority is already pending for adjudication by the Income-tax Authorities. Only when notice u/s l43(2) or 142(1) of the Income-tax Act is issued, the Income-tax Authority assumes jurisdiction to adjudicate the issues that may consist of issues raised in the questions before this Authority. The question cannot be said to be already pending for adjudication before the Income-tax authority unless notice u/s 143(2) is issued before the application is filed. In this case, though return of income was filed before filing of the application before this Authority, notice u/s 143(2) was issued after the application was filed and hence the question cannot be said to be already pending before the Income-tax Authority irrespective of the notice u/s 143(2) being issued subsequently within the prescribed time limit under the Act.

The application is admitted u/s 245R(2) of the Act.

Legal Update

Competition Act

LD/62/81

Grasim Industries Ltd.

vs.

Competition Commission of India

17th December, 2013 (DEL)

Section 26, read with sections 4, 3 and 19, of the Competition Act, 2002 – Procedure for inquiry under Section 19

The Director General has no powers to carry out investigation into an information which, in the first instance, was not considered by the Commission while forming its opinion with respect to existence of a prima facie case of contravention of the provisions of the Act by an enterprise; however, he is at liberty to report contravention of Section 4 only when investigating the information or reference which the Commission had considered while forming its prima facie case and not by entertaining and investigating altogether different information during the course of investigation by the Director General

The report of the Director General to the extent he reported contravention of the provisions of Section 4 by an enterprise by abusing its dominant position as the manufacturer of certain product, cannot be forwarded to the parties in terms of sub-section (4) of Section 26 nor can the Commission hold further inquiry into it in terms of sub-section (8) of Section 26 or proceed to pass order on its basis in terms of Section 27; the Commission may, however, is at liberty to treat the aforesaid part of the report of the Director General as information under Section 19 and proceed accordingly in terms of the procedure prescribed under Section 26

An Information was received by the Competition Commission of India (hereinafter referred to as the 'Commission') that the manufacturers of Man Made Fibres (for short 'MMF') i.e. Polyester Staple Fibre (PSF), Acrylic Staple Fibre (ASF), Viscose Staple Fibre (VSF) & Nylon Staple Fibre (NSF) had imposed several restrictions on Indian Textile Industry, which are their customers for purchase of MMF, and such restrictions constitute anti-competitive actions. The Commission, *vide* order dated 22.06.2011, on consideration of the information submitted by the informant, formed a *prima facie* opinion that there existed a case to direct the Director General to cause an investigation into the matter. The Director General was accordingly instructed to conduct an investigation into the matter. The allegations against MMF manufacturers, who were alleged to be contravening the provisions of Section 3(3)(a)(b)(c). During the course of investigation by the Director General, the informant alleged that Grasim Industries Limited (GIL), which is the petitioner before this Court and is the only manufacturer of Viscose Staple Fibre (VSF) in the country on account of its dominant position in the market of VSF, was indulging into various anti-competitive practices. Different anti-competitive practices were attributed to GIL. The Director General, therefore, decided to investigate. According to the Director General, the petitioner was found to have abused its dominant position in the VSF market, thereby contravening Sections 4(2)(a) & 4(2)(b).

The petitioner was seeking *inter alia* quashing and setting aside of the Director General's report to the extent it pertains to the alleged violation of Section 4 on the ground that investigation into the alleged violation of Section 4 of the Act was beyond the scope of the powers of the Director General, who, in view of the order of the Commission, could have carried out investigation only into the alleged contraventions of Section 3(3)(a)(b)(c).

The High Court of Delhi held as follows:

The scheme of the Act does not permit investigation by Director General into any information which was not considered by the Commission, while forming opinion under sub-Section (1) of Section 26. The formation of opinion by the Commission and direction to cause an investigation to be made by the Director General being a pre-requisite condition for initiation of investigation, the Director General would have no power to undertake investigation in respect of the complaint which the Commission did not consider while forming an opinion and directing

investigation by the Director General. If the Director General investigates an information which the Commission did not consider in the first instance, while forming opinion with respect to existence of a *prima facie* case, such an act on his part shall be *ultra vires* his power under the Act and, therefore, clearly illegal. It is settled legal proposition that when the provisions of a Statute requires an act to be done in a particular manner, such an act can be done only in the prescribed manner and not otherwise. Since the Act requires the Director General to investigate only such information which was considered by the Commission, while forming its opinion with respect to existence of a *prima facie* case, it cannot, of its own carry out investigation based upon an information which was not available to the Commission. It would be appropriate to note here that though MRTP Act, 1969 empowered the Director General to exercise *suo motu* power of investigation, the said power has been expressly denied to him under the Competition Act. In clause (5) of the State of Objects and Reasons for enacting the Competition Act, it is clearly stated that "the Director General would be able to act only if so directed by the Commission, but will not have any *suo motu* power for initiating investigation". If the Director General, is directed by the Commission to cause an investigation to be made into information 'X' and he, besides investigating information 'X' also investigates information 'Y', which was not considered by the Commission, while directing investigation by him, that would amount to conferring *suo motu*, power of investigation upon the Director General which would clearly contravene the scheme of the Act, as far as investigation into complaint 'Y' is concerned.

It is quite understandable if the Commission, on consideration of an information forms an opinion that there exists a *prima facie* contravention of Section 3 and the Director General, while investigating the said information, reports contravention of Section 4 or Section 3 as well as Section 4. Such a report, in my opinion, will not be contrary to the provisions of the Act, since the information which is investigated by the Director General was considered by the Commission, before it formed an opinion in terms of sub-Section (1) of Section 26. If, however, the investigation by the Director General is based upon an altogether different information which the Commission did not consider, while forming its opinion with respect to existence of a *prima facie* case, his action would be contrary to the scheme of the Act and the powers conferred upon him.

Clause (4) of Regulation 18 of the Competition Commission of India (General) Regulations, 2009 requires the Director General to give report containing his findings on each of the allegations made in the information or the reference as the case may be. This is yet another indicator that the report of the Director General is to be confined to the allegations made in the information or the reference received by the Commission and he is not competent to travel outside the said information or reference.

If the Director General carries out investigation into an information which was not considered by the Commission while forming opinion in terms of sub-Section (1) of Section, 26, the Commission

is entitled to either reject that part of the report which pertains to such an investigation or it may in its discretion treat the said information as an information under Section 19 and if the Commission, on examining that part of the report, is of the opinion that there exists a *prima facie* case of contravention of the provisions of the Act, it has to direct the Director General to cause an investigation to be made into that opinion. In the case before this Court, admittedly, the information alleging abuse of its monopolistic position by the petitioner and thereby contravention of the provisions of Section 4, was not considered by the Commission when it recorded a prima facie view that there existed a case to direct the Director General to cause an investigation into the matter. Therefore, the report of the Director General, to the extent he reported contravention of the provisions of Section 4 by the petitioner by abusing its dominant position as the manufacturer of Viscose Staple Fibre, cannot be forwarded to the parties in terms of sub-Section (4) of Section 26 nor can the Commission hold further inquiry into it in terms of sub-Section (8) of Section 26 or proceed to pass order on its basis in terms of Section 27 of the Act. The Commission may, however, is at liberty to treat the aforesaid part of the report of the Director General as information under Section 19 and proceed accordingly in terms of the procedure prescribed under Section 26.

There is no quarrel with the proposition of law that the *prima facie* opinion recorded by the Commission does not bind the Director General which after investigation is at liberty to report that no contravention of the provisions of the Act is made out. That, however, does not enable the Director General to initiate investigation into the information which was not considered by the Commission, while recording its *prima facie* opinion. The Director General is at liberty to report contravention of Section 4 even if the *prima facie* opinion recording by the Commission makes out a case of contravention of Section 3, but this can be done only while investigating the information or reference which the Commission had considered while forming its *prima facie*

case and not by entertaining and investigating an altogether different information during the course of investigation by the Director General.

Violations of provisions of Section 3 may also result in violation of Section 4 as well. What is material in this regard is as to what was the information which was considered by the Commission, while forming its opinion and not whether such an information constituted violation of the provisions of Section 3 or Section 4.

The scheme of the Act and the regulations provide an opportunity to the enterprise against whom an information or a reference is received by the Commission to defend itself firstly before the Director General during the course of investigation and then before the Commission during the course of inquiry, if any, conducted by the Commission, whereas the petitioner before this Court got no opportunity to defend itself before the Director General as far as the information alleging contravention of the provisions of Section 4 is concerned.

Therefore, the report of the Director General, to the extent he has reported contravention of the provisions of Section 4 by the petitioner by misuse of its dominant position as a VSF manufacturer, shall not be subjected to the procedure prescribed in sub-Section (8) of Section 26 nor shall the Commission be entitled to pass order on the said report, in terms of the provisions of Section 27. The Commission, however, shall be entitled to treat the aforesaid part of the report of the Director General as an information in terms of Section 19 and proceed accordingly in terms of the provisions of the Act, if the Commission on consideration of the aforesaid part of the report of the Director General, is of the opinion that there exists a *prima facie* case of contravention of the provisions of Section 4 by the petitioner. ■